

# FDIC State Profile

Spring 2005

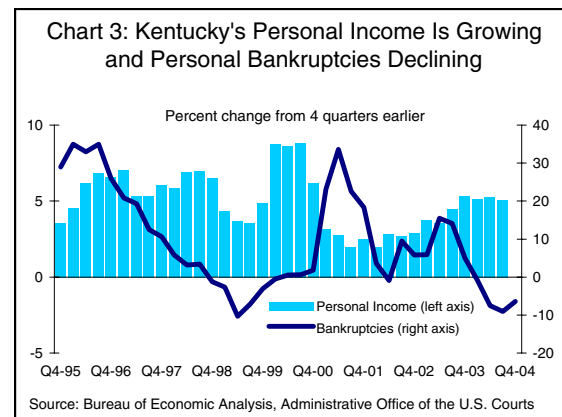
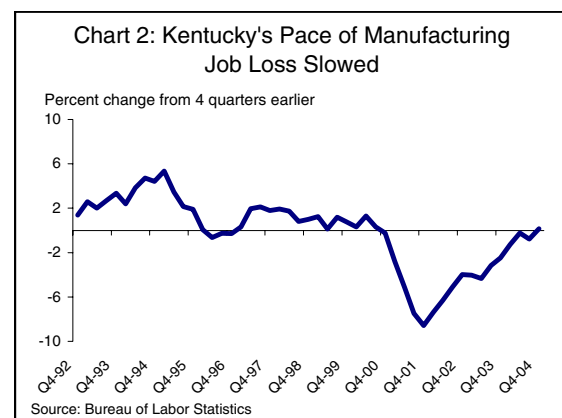
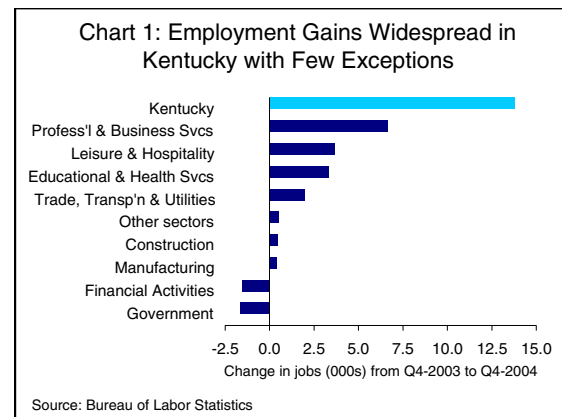
## Kentucky

Kentucky's economy showed continued improvements in 2004.

- Kentucky's unemployment rate fell to 4.7 percent in the fourth quarter from 6.0 percent a year earlier. The unemployment rate in 40 percent of counties, including counties in the **Louisville** and **Lexington** metropolitan areas and adjacent rural counties, dropped 1.5 percent or more in the fourth quarter.
- For the first time since 2000, Kentucky posted positive job growth every quarter in 2004 relative to one year ago. Fourth-quarter employment was 0.8 percent higher than a year earlier, compared with a 0.1 percent decline for the same period a year ago.
- The government sector, which accounts for about 17 percent of Kentucky's non-farm payroll employment, lost 1,600 jobs, or 0.5 percent, from fourth quarter 2003 to fourth quarter 2004 (See Chart 1). The losses occurred in state government, reflecting Kentucky's budget constraints.
- Year-over-year growth in manufacturing employment edged up in fourth quarter 2004 after 16 consecutive quarters of decline (See Chart 2). Productivity increases also contributed to greater manufacturing output, and higher manufacturing activity helped supported hiring in the wholesale trade, trucking, and warehouse sectors.
- Modest employment growth in the Louisville metropolitan area affected commercial real estate submarkets unevenly. The office vacancy rate for downtown space rose over the year, ending at 21.4 percent. Higher net absorption contributed to a meaningful drop in the suburban vacancy rate, which ended the year at 17.1 percent. However, Class A space attracted tenants at the expense of many Class B properties.<sup>1</sup>

**Financial conditions for households remain healthy.**

- The low unemployment rate and positive job growth in Kentucky led personal income to rise about 5 percent each quarter since the fourth quarter of 2003 (See Chart



<sup>1</sup>Grubb & Ellis Research, Fourth Quarter 2004.

3). Such growth likely contributed to the decline in bankruptcies and foreclosures throughout 2004 and helped sustain the strong housing market.

- Existing home sales remained high in 2004 but showed little growth compared with the same quarters in 2003. Total permits for residential buildings grew 8.8 percent in fourth quarter 2004, but development was uneven among housing types. Multi-family permits spurred almost all of the growth in new permits, while single-family permits dropped 3.2 percent from a year ago after a strong start in 2004.

## Kentucky's community institutions<sup>2</sup> post strongest earnings in four years.

- At community institutions, lower provisions for loan losses during 2004 propelled net income 17 percent higher to \$334 million, the highest in several years.
- The net interest margin improved modestly in 2004 for community institutions in Kentucky and contributed to a 10 basis-point improvement in the aggregate return on assets (See Table 1).
- Core deposits to assets dropped to 65.5 percent, almost 2 percentage points lower than one year earlier. The rise in noncore funding mainly reflected growth in large certificates of deposit, with smaller increases in borrowings and large brokered deposits.
- Funding costs for all insured institutions increased slightly in the second half of 2004 as the federal funds rate increased to its highest level since 2001 (See Chart 4). Recent developments suggest that rising short-term interest rates will contribute to higher funding costs in future quarters.

## Asset quality improvement continued.

- The year 2004 marked the second year of improved asset quality at Kentucky's community institutions, and the improvement was widespread among major loan categories (See Chart 5). Noncurrent loans fell \$14 million, or 6.5 percent, during the quarter. Charge-offs to total loans equaled 0.38 percent in the fourth quarter, a seasonal increase from the third quarter charge-off rate, but down compared with fourth quarter 2003.
- The past-due rate on home equity loans countered the trend, rising by six basis points in 2004. Home equity loans at community institutions grew nearly 35 percent last year, representing the fastest growing loan category. Home equity loans accounted for only 3.7 percent of the

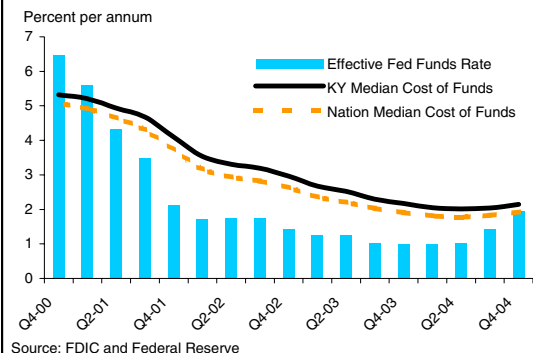
total loan portfolio at year-end, and their past-due rate of 0.74 percent was relatively low. Rapid growth, however, could hold down the past-due rate, as the portfolio is unseasoned and problem loans may have not surfaced yet.

**Table 1: Lower Provision Expense Boosts Profitability**

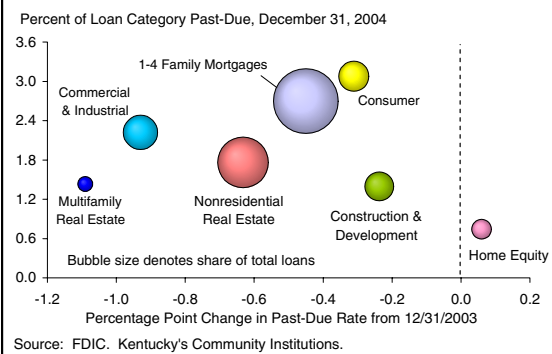
	Income statement contribution (as a percentage of average assets)		
	Calendar year		Percentage Point Change
	2003	2004	
Net Interest Income	3.62	3.65	0.03
Noninterest Income	0.88	0.83	-0.05
Noninterest Expense	-2.88	-2.93	-0.05
Provision Expense	-0.42	-0.22	0.20
Security Gains & Losses	0.05	0.04	-0.01
Income Taxes	-0.28	-0.30	-0.02
Net Income (ROA)	0.97	1.07	0.10

Source: FDIC. Kentucky Community Banks and Thrifts.

**Chart 4: Funding Costs Rise with Fed Funds Rates**



**Chart 5: Loan Quality Improvement Is Widespread**



<sup>2</sup>Community Institutions are insured institutions with less than \$1 billion in assets, excluding new (less than three years old) and specialty banks.

## Kentucky at a Glance

**ECONOMIC INDICATORS** (Change from year ago quarter, unless noted)

<b>Employment Growth Rates</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Total Nonfarm (share of trailing four quarter employment in parentheses)	0.8%	-0.1%	0.1%	-2.3%	1.1%
Manufacturing (15%)	0.0%	-2.4%	-3.9%	-8.5%	-0.2%
Other (non-manufacturing) Goods-Producing (6%)	0.7%	-0.1%	-4.3%	1.5%	-2.2%
Private Service-Producing (62%)	1.3%	1.0%	1.3%	-2.0%	1.7%
Government (17%)	-0.2%	-1.9%	1.0%	1.5%	1.2%
Unemployment Rate (% of labor force)	4.7	6.0	5.9	5.7	4.5

<b>Other Indicators</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Personal Income	N/A	5.3%	2.9%	2.5%	6.2%
Single-Family Home Permits	-3.2%	12.0%	4.6%	7.2%	-9.4%
Multifamily Building Permits	79.0%	2.2%	9.4%	-22.0%	-40.3%
Existing Home Sales	13.3%	10.2%	3.5%	11.7%	13.2%
Home Price Index	5.8%	4.4%	3.7%	4.8%	4.7%
Bankruptcy Filings per 1000 people (quarterly level)	1.55	1.66	1.62	1.52	1.29

**BANKING TRENDS**

<b>General Information</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Institutions (#)	237	243	249	258	267
Total Assets (in millions)	51,470	47,465	55,447	58,655	55,652
New Institutions (# < 3 years)	5	7	13	16	16
Subchapter S Institutions	49	43	38	32	32

<b>Asset Quality</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Past-Due and Nonaccrual Loans / Total Loans (median %)	2.07	2.41	2.44	2.45	2.22
ALLL/Total Loans (median %)	1.29	1.29	1.27	1.20	1.16
ALLL/Noncurrent Loans (median multiple)	1.82	1.49	1.54	1.52	1.63
Net Loan Losses / Total Loans (median %)	0.17	0.20	0.21	0.20	0.14

<b>Capital / Earnings</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Tier 1 Leverage (median %)	9.51	9.17	9.14	9.32	9.47
Return on Assets (median %)	1.10	1.05	1.06	1.02	1.12
Pretax Return on Assets (median %)	1.40	1.38	1.40	1.42	1.53
Net Interest Margin (median %)	4.03	3.95	4.04	3.97	4.21
Yield on Earning Assets (median %)	5.77	6.02	6.80	7.99	8.44
Cost of Funding Earning Assets (median %)	1.73	2.06	2.75	3.99	4.23
Provisions to Avg. Assets (median %)	0.17	0.21	0.23	0.22	0.19
Noninterest Income to Avg. Assets (median %)	0.68	0.72	0.68	0.65	0.60
Overhead to Avg. Assets (median %)	2.96	2.87	2.86	2.88	2.86

<b>Liquidity / Sensitivity</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Loans to Assets (median %)	68.8	65.7	65.9	66.1	68.1
Noncore Funding to Assets (median %)	20.6	20.3	19.6	20.2	19.8
Long-term Assets to Assets (median %, call filers)	19.7	21.0	20.3	18.5	18.2
Brokered Deposits (number of institutions)	43	36	36	39	41
Brokered Deposits to Assets (median % for those above)	3.5	3.0	1.2	1.1	1.0

<b>Loan Concentrations (median % of Tier 1 Capital)</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Commercial and Industrial	54.2	54.1	61.0	61.1	64.6
Commercial Real Estate	163.7	154.6	143.8	138.9	132.0
Construction & Development	22.9	21.3	20.5	20.4	16.9
Multifamily Residential Real Estate	5.5	5.2	4.6	4.6	2.9
Nonresidential Real Estate	119.5	116.0	109.9	107.9	98.9
Residential Real Estate	292.2	287.9	287.1	279.2	281.4
Consumer	57.0	66.7	76.6	79.7	83.1
Agriculture	48.0	50.4	50.7	46.4	50.4

**BANKING PROFILE**

<b>Largest Deposit Markets</b>	<b>Institutions in Market</b>	<b>Deposits (\$ millions)</b>	<b>Asset Distribution</b>	<b>Institutions</b>
Louisville, KY-IN	51	19,335	< \$250 mil.	200 (84.4%)
Lexington-Fayette, KY	34	6,502	\$250 mil. to \$1 bil.	31 (13.1%)
Huntington-Ashland, WV-KY-OH	28	3,453	\$1 bil. to \$10 bil.	6 (2.5%)
Clarksville, TN-KY	15	2,208	> \$10 bil.	0 (0%)
Owensboro, KY	14	1,966		